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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

October Term, 1950.

No. 581.

ROYAL INDEMNITY COMPANY,
a Corporation, - - - - - - Petitioner,

versus

UNITED STATES OF AMERICA, - - - Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

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May it please the Court:

The respondent's brief in opposition to the petition for certiorari beclouds the issues in several important respects. We therefore submit this reply brief, for the sole purpose of assisting the Court to understand the true issues in the case.

I. RESPONDENT'S STATEMENT OF THE QUESTIONS PRESENTED IS NEITHER ACCURATE NOR COMPLETE.

The respondent's statement of the questions presented is not accurate. The question is not whether the asessment against Louisville was rendered void by the "filing of a consolidated return * * * and the collection" of a tax from American. The question is whether Louisville's tax liability was adjudicated to be non-existent by a *judgment* holding that the entire consolidated tax was assessable against American and only against American. The issue is correctly set forth as Question 4 at pages 2-3 of the petition.

Furthermore, the respondent's statement of the questions presented is not complete. Questions 1, 2, 5 and 6, set forth in the petition, are properly raised on this record and are before the Court.

II. RESPONDENT'S STATEMENT OF FACTS IS MATERIALLY ERRONEOUS.

The respondent's statement of the facts contains one error which pervades its entire argument. The error is found in respondent's assertion that the Board of Tax Appeals, in determining American's deficiency, credited American with the amount of the uncollected assessment against Louisville which is here in question. On the basis of said assertion (which is erroneous, as we shall hereafter show), the respondent contends in effect that the tax on Louisville is justified by a tax

benefit to American, Louisville's parent corporation, resulting from the assessment against Louisville.

Let us see what the record shows as to how the B. T. A. determined the amount of the deficiency.

The record shows that the B. T. A. found, as a matter of substantive law, that American was liable for the entire consolidated tax, without abatement for taxes assessed against, or even for taxes paid by, the subsidiaries. Its opinion, which is incorporated in the record by citation in Finding 17 of the court below (R. 18), recognizes and regrets the fact that this would result in double liability for the affiliated group as a whole. At 23 B. T. A. 697-698, the Board said:

> "Our decision is not based upon the theory of estoppel advanced by the respondent, and *to the extent that it may result in the payment of consolidated taxes upon income on which taxes have already been paid by the companies severally, is reluctantly rendered.* We are, however, of opinion that there existed among the petitioner and its subsidiaries an agreement that consolidated tax liabilities of the affiliated group for the years 1917, 1918, and 1919 should be allocated for assessment to petitioner alone. See *Bermont Oil Co.*, 22 B. T. A. 182, and cases cited therein." (Emphasis added.)

And in his proposed settlement under Rule 50, the Commissioner sought to take full advantage of this ruling by claiming a deficiency balance of $299,519.56. (Finding 18, R. 18.)

It then was discovered, however, that the Commissioner had made a procedural error. Not anticipating the huge and unjust windfall which would accrue to the Government if the B. T. A. sustained his position, he had made no motion to enlarge the deficiency of $33,929.20 proposed in his deficiency letter. Under the law as previously announced by the Board in *Pitman* v. *Commissioner,* 24 B. T. A. 244 (decided September 30, 1931), the Commissioner was thereby disabled to obtain judgment for more than $33,929.20, even though on the merits he had established his claim for $299,519.56. Counsel for American pointed this out in the hearing before Member Love on settlement under Rule 50. Member Love, who had just written the Board's opinion in the *Pitman* case, expressed agreement with this position. (Finding 21, R. 20-21.)

The record does not expressly show on what basis the B. T. A. arrived at its judgment as to the amount of American's deficiency. No opinion was written explaining the computation of the judgment, and after a lapse of nearly two decades it has been impossible for either party to adduce any direct evidence on that point in this case, except of course the Board's opinion on the merits reported in 23 B. T. A. 670. However, such inferences as can legitimately be drawn from the record point unmistakably to the conclusion that the Board's judgment was based on the Commissioner's failure to enlarge the proposed deficiency set forth in the 60-day letter, and was *not* predicated on the allowance of a credit to American for taxes assessed against its subsidiaries.

In the first place, the allowance of such a credit would have directly contravened the Board's official opinion on the merits. This opinion was never withdrawn or modified, and thus establishes, at least *prima facie,* the Board's reasoning.

In the second place, there is no indication that the Board disagreed with Member Love's view, referred to above, that the Commissioner was limited to the deficiency proposed in his 60-day letter.

In the third place, we are not left in doubt as to the Board's reason for entry of judgment in the amount of $39,362.70 instead of the $33,929.20 deficiency proposed in the 60-day letter. The difference of $5,433.50 is explained in Finding 20. (R. 19-20.) It resulted from American's voluntary action in consenting to this increase.

The record does not inform us, and we do not know, what motivated this seeming concession. It resulted from a change in the Commissioner's figure for taxes assessed against and paid by Sweetwater Woolen Mills, another subsidiary of American which is not a party to this record. Perhaps the concession was made in return for a reciprocal concession by the Commissioner with respect to Sweetwater. Perhaps it was made in recognition of a simple clerical error contained in the 60-day letter, which American for reasons of its own did not wish to take advantage of. Since Louisville and petitioner, its surety, were not represented in that proceeding, we have no way of knowing why the concession was made. But for that very reason it would be doubly improper to make the inference, for the pur-

pose of imposing a tax liability on Louisville and petitioner, that the *Board,* repudiating *sub silentio* its then recent ruling in the *Pitman* case, had held that the Commissioner was not, as a matter of law, limited to the amount claimed in the 60-day letter. The most that can be inferred is that American, for reasons of its own, *consented to a strictly limited relaxation of the* Pitman *rule.*

We regret the necessity of analyzing the record at such length. We cannot, however, leave unchallenged the implication contained in respondent's brief, that the assessment against Louisville produced a tax benefit for its parent corporation in the B. T. A. It simply is not so.

III. RESPONDENT'S LEGAL POINTS ARE NOT WELL TAKEN.

(a) It is not true, as respondent asserts, that this case involves no question of importance because it "involves provisions of the 1918 Revenue Act which have long since been changed." The case involves an important question of limitations under extension bonds, which are still used in administration of the income tax laws. Reg. 111, Sec. 29.56-2.

The case also involves basic questions of administrative fairness, which have a continuing and increasing importance. Two decisions of the Court of Appeals for the District of Columbia, handed down after the filing of the petition for certiorari in this case, afford ample confirmation of the present importance

of such cases. In *Stockstrom* v. *Commissioner*, 51-1 USTC Par. 10, 801 (decided March 29, 1951), the Commissioner of Internal Revenue had sought to take advantage of the taxpayer's failure to file a gift tax return, despite the fact that said failure resulted from the taxpayer's reliance on a ruling of the Commissioner which was subsequently changed. The Court held in favor of the taxpayer, saying:

> "It has been well said that the government should always be a gentleman. Taxpayers expect, and are entitled to receive, ordinary fair play from tax officials. We regard as unconscionable the Commissioner's claim of authority to assess a tax in 1948 because of Stockstrom's failure to file a return for 1938, when the Commissioner himself was responsible for that failure."

And on May 18, 1951, in the case of *Dollar* v. *Land*, the same court held a number of high Federal officials, including the Secretary of Commerce, to be in contempt because of their refusal to comply with the mandate of the court. According to the *New York Times*, May 19, 1951, page 25, the Court rejected the contention of the officials that as agents of the sovereign Government they enjoy a privileged status, saying:

> "There is nothing new in the difficulties of that position. It has existed at least since the English judges began to assert the supremacy of the common law over government absolutism."

Preservation of the principle that executive officials of the United States Government are not above the law is a matter of unequaled importance; and more than a few such officials today are challenging, by their

acts if not by their words, the present validity of that principle.

(b) Point 1 of respondent's argument fails to meet the issue. As stated above, the question is not whether Louisville's assessment was nullified by the *filing of the consolidated return,* but whether it was wiped out by a *final judgment* that American alone was liable for the consolidated tax.

(c) Point 2 of respondent's argument is based on an erroneous premise. Respondent says that the court below "fully considered the legality of the assessment against Louisville." The lower court's opinion shows on its face that it did not do so. The court said that the Sixth Circuit Court of Appeals in *American Textile Woolen Co.* v. *Commissioner,* 68 F. 2d 820 (1934), cert. denied 293 U. S. 558 (1934), had "finally determined" Louisville's tax to be due, and that its decision "cannot be questioned here." (R. 30.) For that reason, the court below refused to pass on the substantive question of Louisville's liability for the tax.

Nor is it true, as respondent asserts, that petitioner was afforded a hearing on the merits in *Royal Indemnity Co.* v. *United States,* 120 F. 2d 136 (1941), cert. denied 315 U. S. 797 (1942). The court there made certain statements bearing on the substantive question of Louisville's tax liability, which statements are made the subject of a footnote reference in respondent's brief. The court made it plain, however, that these statements were pure dictum. It expressly held (p. 139):

> "The liability for the tax as tax may have been terminated, *though this we do not decide,* or, as in United States v. John Barth Co., 279 U. S. 370, 49 S. Ct. 366, 367, 73 L. Ed. 743, collection may become impossible because of the running of time, but this has no bearing upon the obligation of the surety upon the bond." (Emphasis added.)

It is clear, both on principle and on authority, that the due process requirement of an opportunity for hearing is satisfied only by an opportunity for a full hearing *on the merits. Central of Georgia R. Co.* v. *Wright,* 207 U. S. 127 (1907); *Turner* v. *Wade,* 254 U. S. 64 (1920); *Brinkerhoff-Faris Trust & Savings Co.* v. *Hill,* 281 U. S. 673 (1930).

(d) Point 3 of respondent's argument explains how the *Commissioner* happened to propose a deficiency of only $33,929.20 in his 60-day letter. It has nothing to do with the decision of the B. T. A. and the Sixth Circuit Court of Appeals in the *American Textile Woolen Co.* case, and fails to reconcile that decision with the decision of the Court of Claims in this case.

It is true that the *Commissioner's* determination of deficiency, embodied in his 60-day letter, was computed on the basis of credits for all taxes previously assessed, including the assessment against Louisville which is involved in this case. That determination, however—as the court below expressly found (Findings 11 and 13, R. 16, 17)—was made not for American alone but for "American *and its subsidiaries.*" It was obviously necessary for the Commissioner, in determining the deficiency for the entire affiliated group, to take ac-

count of assessments against the subsidiaries as well as American.

But at that stage of the proceedings, in 1925, the Commissioner had not yet developed the ingenious theory that American (by virtue of an implied agreement) was alone liable for the entire consolidated tax. That idea appeared only after the Commissioner, by failing to address his 60-day letter properly, had lost the right to make additional assessments against the subsidiaries.

The sequence of events is instructive. First the Commissioner sought to propose a deficiency against the entire affiliated group, in the amount of $33,929.20. Because of an error in the address of the 60-day letter, he was limited to an assessment against American. He then "found" that American had assumed the obligation to pay the whole consolidated tax, and American was unable to convince the B. T. A. that it had not done so. The logic of the B. T. A.'s decision would have given the Commissioner a windfall of more than $200,000.00, except for his failure to make a motion to enlarge the proposed deficiency. Consequently, the Commissioner obtained judgment only for the proposed deficiency, plus $5,433.50 voluntarily conceded by American.

From the above recital it becomes crystal clear that the B. T. A. allowed American no credit for taxes assessed against Louisville. The Commissioner had allowed such a credit to the affiliated group as a whole, but his subsequent shift of position rendered immaterial the assessment against the subsidiaries; and, in any

event, the Commissioner's *ratio decidendi* has no bearing on this case.

(e) Point 4 of respondent's argument misconceives the nature of the limitations question here involved. We do not claim that the *assessment* against Louisville came too late. We claim, rather, that the *collection* came too late. The applicable limitations statutes, set forth in the petition, contain time limits for collection as well as assessment.

(f) Point 5 of respondent's argument is unsupported by the record and is contrary to fact. It is not true that our position would "produce the anomalous result that the tax in question is not collectible from anyone." Our position is that only one taxpayer, not two, can be primarily *liable* for the tax in question. We submit, further, that there is nothing "anomalous" about the inability of the Government to *collect* a valid tax; such a result often ensues where a taxpayer becomes insolvent (as American did here) or where the Commissioner permits the statute of limitations to run (as we think he did here).

The *collectibility* of the tax depends on (a) the financial responsibility of the person who is obligated for it, and (b) the adherence by the tax authorities to the procedural rules established by law. We submit that tax liability does not depend on the financial responsibility of the taxpayer, and that Louisville's liability is neither enlarged nor diminished by the fact that petitioner, its surety, is at present the only solvent person in sight. We submit further that petitioner, by executing Louisville's bond, did not absolve the

Commissioner from his duty to follow established legal procedures, or assume the risk of the remarkable results which have flowed from the Commissioner's efforts to escape the consequences of his own procedural irregularities.

Finally, we submit that no one can say, at the present time, whether the Government is better or worse off financially as a result of the filing of the abatement claim and bond, and the consequent delay in collection of the tax here in question. For all that appears, if Louisville had been forced in 1921 to pay the tax here in question, it might have filed a timely claim for refund of its entire 1918 tax rather than only one-fourth of it; and, in the light of subsequent events (including the adjudication of American's liability for the whole consolidated tax, and American's subsequent insolvency) this might have worked to the Government's ultimate disadvantage.

It is fruitless, however, to speculate on such possibilities. Where insolvency has intervened, it is never possible to reconstruct hypothetical tax consequences. The only possible approach is to accept and be guided by the rules of law laid down by Congress and the courts. And on this basis it is clear that, for the reasons set forth in the petition, this Court should grant certiorari and reverse.

Respectfully submitted,

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